

## Stakeholder Comments Template

### Subject: Capacity Procurement Mechanism, and Compensation and Bid Mitigation for Exceptional Dispatch

Submitted by	Company	Date Submitted
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This template was created to help stakeholders structure their written comments on topics related to the July 15, 2010 Straw Proposal for Capacity Procurement Mechanism (“CPM”), and Compensation and Bid Mitigation for Exceptional Dispatch. Please submit comments (in MS Word) to [bmcallister@caiso.com](mailto:bmcallister@caiso.com) no later than the close of business on July 30, 2010.

Please add your comments where indicated responding to the topic or question raised. Your comments on any aspect of the straw proposal are welcome. The comments received will assist the ISO with the development of the Draft Final Proposal.

Please provide your comments on the following topics and questions. Your comments will be most useful if you provide the reasons and the business case for your preferred approaches to these topics.

#### Introductory Comments

NRG strongly supports the CAISO’s plan to enhance its backstop capacity procurement system, and to compensate generators at the levelized Cost of New Entry in the event that resources needed for reliability are not receiving adequate compensation under the Resource Adequacy program (described as “Option A” in the CAISO’s proposal).

Ensuring that existing generating resources needed for reliability receive adequate revenues to continue operating is a critical problem in California today. Currently, many generating resources are not identified as Resource Adequacy units even though they are: (a) necessary to support grid reliability under certain contingencies, (b) are necessary to reliably support renewables integration, (c) are *likely* to be needed for these purposes in future years, but are not currently economic without additional revenues; and (d) are not designated as Reliability-Must Run units.

Such “steel in the ground” units are unlikely to recover sufficient revenues (without significant reforms to the existing market structure) in the energy markets to continue participating long-term in the CAISO markets on a long-term basis, and are likely to begin retiring just as the CAISO needs additional gas-fired generation to support renewables integration. The shuttering of plants in response to 316(b) Once-Through Cooling regulations is likely to cause additional problems over the same two- to five-year timeframe.

The CAISO needs the flexibility to designate these units under the CPM program and provide an additional stream of revenue. Otherwise, the CAISO will have no means of retaining such units for reliability or grid operating flexibility. Further, as the CAISO recognized in its own comments to the CPUC, the existing Resource Adequacy program is not sufficient, without a backstop, to discharge the CAISO’s independent legal obligation to ensure the reliability of the bulk power system. Thus, the CAISO’s proposal to improve its backstop capacity procurement is a critical step in ensuring the reliability of the California transmission system and should be implemented on an expedited basis.

### CPM

1. The appropriate duration of the tariff provisions associated with the CPM: should they be permanent or terminate on a certain date or under certain conditions? If the CPM should terminate, please be specific about the date or conditions upon which it would terminate and indicate the reasons for your proposal.

Absent a fundamental change in the structure of California’s capacity markets, NRG recommends making the CPM program a permanent part of the CAISO’s tariff. However, NRG also recommends that the CAISO commit to undertaking a systematic and thorough review of the program every two years.

As part of this review, the CAISO should clearly identify a series of metrics under which it will evaluate the CPM program. In particular, the CAISO should (a) evaluate whether units needed for reliability are being picked up by the Resource Adequacy program; (b) whether units needed for reliability and operating flexibility are receiving adequate compensation to justify their long-term participation in the energy markets; (c) determine whether its primary reliance on the CPUC’s Resource Adequacy program to maintain grid reliability is sufficient to maintain reliability; and (d) update the cost of new entry and going-forward cost estimates relied upon in the CAISO’s proposal.

2. The appropriate treatment of resources that may be procured through CPM or Exceptional Dispatch but then go out on Planned Outage during the period for which the resource has been procured. What are your views on the proposed formula in the straw proposal for compensating such resources?

Ideally, resources receiving an Exceptional Dispatch or CPM designation should be compensated on an annual basis for the reliability services they provide. However, if the CAISO elects to continue month-by-month procurement of resources, NRG generally agrees that resources should only receive compensation for the period in which the resource provides service.

3. Modification of the criteria for choosing a resource to procure under CPM (section 43.3) to provide the ISO with the ability to procure non-use limited capacity over use-limited capacity.

NRG has serious concerns regarding the proposal to select non-use limited resources before selecting use-limited resources. As the ISO is aware, many fossil units in California have their total run hours limited by their air permits. As a practical matter, these limitations rarely come into play for peaking or high heat-rate units, and are largely irrelevant for monthly designations. In particular, resources limited due to physical characteristics (e.g., hydro resources) should be distinguished from resources that are use-limited because of annual air emissions requirements, but that are otherwise fully capable of responding to a dispatch.

NRG understands that resources that are use-limited because of air permit limitations are required to meet the Must Offer obligation applicable to all Resource Adequacy or CPM-designated resources. Additionally, bids from such resources already take into account lost opportunity costs and units are required to run, as dispatched, until their total number of run hours is expired.

Finally, it is important to note that all use-limited resources submit a use-limited plan, which can be updated monthly, that should aide the ISO is determining which resource best fits its needs. When the plan indicates that a resource has sufficient runtime available, the ISO should have the flexibility to procure use-limited resources that best fit the operational needs of the system.

4. The three new types of procurement authority for generic backstop capacity the ISO is proposing.

The ISO needs the operational flexibility to procure additional backstop capacity for any of the three categories of need identified in the Straw Proposal. While NRG supports providing the CAISO the maximum operational flexibility regarding parts (a) and (b) of the ISO's Straw Proposal, we focus our comments on part (c) of the proposal, which is designed to ensure that the CAISO is able to retain resources that it needs to reliably operate the transmission system.

In particular, the CAISO correctly identifies the concern; there are many older generating units – particularly those within load pockets – that are needed to reliably operate the transmission system, but that are not currently Resource Adequacy-

designated units. This creates a scenario where these units have no means of earning enough revenues in the existing energy markets to economically justify their continued operation. Such plants are likely to retire, particularly given the increased environmental capital expenditures that will be necessary to keep these units operating over the next several years, including the Once-Through Cooling requirements.

It is critical to system reliability that the ISO have the ability to “look forward” and identify units that may not be required for annual reliability today, but are almost certain to be needed for reliability in two to three years, given projected retirements, load growth, increased renewables penetration, transmission constraints, etc. The CAISO should have the ability to identify such resources and provide them sufficient revenues to allow them to continue operating. In short, the CAISO must step in and fill the gap left by the CPUC’s decision to not institute a forward Resource Adequacy program by identifying and compensating such resources. Otherwise, the CAISO will not be able to ensure that it has sufficient resources under contract to ensure system reliability, both in the immediate, as well as the two-to-five year forward timescale.

5. The compensation that should be paid for generic capacity procured under CPM and Exceptional Dispatch. Which method do you support: Option A – CONE net of peak energy rent; or Option B – going forward costs? Are there further modifications needed to either of these pricing options? If you have a specific alternative pricing proposal, please provide it and indicate the reasons for your proposal.

NRG supports Option A and the proposal to compensate generation resources needed for reliability at the levelized cost of new entry, or CONE. NRG’s experience shows that the \$229/kW-year represents a reasonable approximation of the cost of redeveloping a brownfield unit. NRG has been actively working to repower both its large gas-steam facilities El Segundo and Encina. As such, NRG agrees Option A – CONE of \$229/kW-year – is a fair representation of what the cost of new entry is in the real world. The current RA cap of \$41/kW-year or the proposed Option B price of \$55/kW-year both share one attribute; neither comes close to representing what it costs to build, own and maintain a generation asset in the state of California.

As experience in the eastern capacity markets has shown, capacity suppliers will not enter or remain in a market that does not provide both a contribution to the fixed costs of a generation facility. The current Resource Adequacy market provides only sufficient revenues to cover some going-forward costs, and provides no contribution to fixed cost recovery. The result is that new generating resources are typically not entering the California energy markets, unless they have sufficient sources of out-of-market revenues – typically a PPA.

The goals of the CPM program should be two fold: (1) retain sufficient generating resources to ensure system reliability; and (2) provide locational price signals that will inform generating and transmission resources where they should direct their investment dollars. Both of these goals can only be accomplished by providing resources needed

for system reliability with adequate revenues (and corresponding Must Offer obligations) to ensure that they remain available to provide reliability services. In fact, the only just and reasonable rate of compensation for providing such services is to ensure that the resource has the opportunity to recover the Cost of New Entry, levelized over the expected lifetime of the facility – something the current Resource Adequacy and energy markets fall far short of providing. Without a backstop such as the one proposed by the CAISO, system operators will have no means of ensuring that capacity suppliers will continue participating in the energy markets or that the ISO will have the resources it needs to dispatch the system.

6. The need for the ISO to procure non-generic capacity under CPM and Exceptional Dispatch to meet operational needs.

The ISO should continue procuring generic capacity under the CPM and Exceptional Dispatch programs. Units capable of providing ancillary services or other services should receive additional compensation from those separate markets. FERC has been clear over the years that a megawatt of capacity is a megawatt of capacity, and that the reliability service provided by capacity is non-differentiated (with the exception of location).

To the extent that the existing ancillary services markets are not making it financially attractive for capacity resources to provide the necessary attributes, the ISO should focus on strengthening those ancillary services markets and/or creating new products to respond to specific needs. The capacity backstop program is not the appropriate place to procure non-generic capacity.

7. The operational criteria the ISO is proposing to distinguish certain operational characteristics as non-generic capacity (fast ramping and load following). Are these two characteristics enough, or do you propose additional criteria for operating characteristics that would qualify for non-generic capacity?

As discussed in Question 6, the ISO should focus on compensating units capable of fast ramping or load following through the ancillary services markets.

8. How should non-generic capacity be compensated? What are your views on the proposal to compensate non-generic capacity by applying an adder to the price paid for generic capacity?

The CAISO should ensure that its ancillary services markets are providing sufficient revenues to incent capacity suppliers to provide the needed reliability services. If the existing ancillary services market is not sending the correct price signals or is not procuring the necessary service, then the ISO should modify its ancillary services markets.

Exceptional Dispatch

1. Should energy bids for resources dispatched under Exceptional Dispatch continue to be mitigated under certain circumstances? Should such mitigation continue the current practices of bid mitigation as outlined in the straw proposal?

No. As Exceptional Dispatches become less frequent, there is no need to mitigate energy bids from such resources. Exceptional Dispatches are by definition unusual and rare, and should only occur due to unforeseen circumstances. Because Exceptional Dispatches are not planned for, a market participant has little or no indication that an Exceptional Dispatch will be issued, and thus has no economic incentive to withhold otherwise economic generation waiting for an Exceptional Dispatch that may never come.

Additionally, as the ISO considers changes to its mitigation of energy bids from exceptionally dispatched resources, it must take into consideration (1) the severe price suppression caused by these dispatches and their impact on existing generating units and (2) the lack of price signals sent by such excessive mitigation. There is a direct feedback loop between the suppression of energy market prices and the problems identified by the ISO regarding compensation for existing units that will be needed to support renewables integration and maintain reliability. In short, the excessive mitigation of Exceptionally Dispatched units (which are by definition needed for reliability) adds to the inability of such resources to recover their costs. We urge the ISO to complete a vigorous competitive path assessment of all paths within the ISO's footprint so that the market can be assured that only those units who truly possess market power are mitigated, instead of the current practice of simply assuming most units have the ability to exercise market power. Further, NRG disagrees with the ISO's assertion that, because no market power has been observed, the market is functioning properly. Such a conclusion ignores the underlying fact that over-mitigation is extremely damaging to the market. Moreover, over-mitigation may provide the appearance of a smoothly functioning market, when in fact it undermines the market.

Further, excessively mitigating energy bids from exceptionally dispatched resources also impairs the ability to signal the need for new entry in areas subject to Exceptional Dispatches. Mitigating an Exceptionally Dispatched unit to its costs (or even below its true costs, in some cases)<sup>1</sup> sends exactly the wrong price signals. Eliminating or loosening the existing mitigation would clearly improve market functioning.

2. Should the ISO change the categories of bids subject to mitigation under Exceptional Dispatch (Targeted, Limited and FERC Approved) and extend the bid mitigation for the existing categories?

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<sup>1</sup> As NRG detailed in its comments to the "Bidding and Mitigation of Commitment Costs" proceeding, the current mitigation methodology often under-compensates exceptionally dispatched units because it (a) does account for all applicable gas taxes or (b) intra-day gas price fluctuations that are often necessary to meet exceptional dispatches. The result is that exceptionally dispatched units are sometimes made to operate below their actual costs.

The ISO's delay in conducting an updated "competitive path assessment" is one of the single biggest problems with the existing mitigation. Currently, the ISO simply assumes that all paths are non-competitive without conducting any supporting analysis. The correct market methodology is to declare all paths competitive unless proved otherwise. At a minimum, the CAISO should detail its plan for evaluating all paths on an expedited basis.

3. What is the appropriate compensation for non-RA, non-RMR and non-CPM capacity that is Exceptionally Dispatched? Should the current compensation methodology be extended, updated to agree with what is put in place for CPM for generic capacity procurement?

Units receiving an Exceptional Dispatch should receive a yearly payment equal to the CONE, levelized over a 20 year period. Doing so ensures that resources that are needed for reliability (which exceptionally dispatched units are by definition) receive just and reasonable revenues. Doing so provides the appropriate incentives for the CPUC to assure that the Resource Adequacy program properly identifies resources needed for reliability.

#### Other

1. Do you have any additional comments that you would like to provide?

Thank you for the opportunity to provide comments.